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MICHAEL RODAK, JR.,

IN THE

Supreme Court of the United States

OCTOBER TERM, 1972

No. 72-1616

BOGUE ELECTRIC MANUFACTURING CORPORATION, EDWARD P. SCHINMAN, ROBERT S. HERWIG, WILLIAM S. GUTTENBERG and MURRAY REIFFIN,

Petitioners,

—v.—

HERMAN L. ZELLER, IRWIN SMALL COMPANY, a Partnership, and BELCO POLLUTION CONTROL CORPORATION,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITIONERS' REPLY BRIEF

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Justification for Reply Brief

Petitioners seek a Writ of Certiorari to gain review of an erroneous decision of the United States Court of Appeals for the Second Circuit which overcame a clear jurisdictional defect in the record below by deciding an important federal question in a way in conflict with applicable decisions of other Circuits which have relied upon early decisions of this Court.

That important federal question is whether under §28(a) of the Securities Exchange Act which limits recovery to "actual damages on account of the act complained of,"

an allegedly defrauded buyer, whose out of pocket loss has been fully recompensed may also recover such non-out of pocket items as lost profits, gains prevented and consequential damages (Pet., p. 2).

In an unprecedented departure from settled federal law, the Second Circuit approved such an expansion of recoverable damages, reversing the District Court's contrary holding (See Pet., p. 21a).

Nowhere in Respondent's Brief in Opposition, except for the formal wording of its "Point I," does Respondent challenge Petitioners' contention that there is a clear conflict between the Circuits and that the Second Circuit changed the federal measure of recoverable securities fraud damages. Instead, Respondent's Opposing Brief introduces new matter in an attempt, exclusively, to argue that *special facts* in the record below reduce the conflict between the Circuits to a conflict *in principle* rather than a conflict *in holdings,* asserting that the instant case *on its facts* justifies an expanded measure of damages for any of three reasons:

1. that there still exists an unrecovered out of pocket loss, bringing the case *within* the out of pocket rule for defrauded buyers (Brief in Opp., pp. 4-6); or
2. that Respondent is really a defrauded seller for damage purposes, taking the case *out of* the out of pocket rule for defrauded buyers (Brief in Opp., pp. 10-12); or
3. that Respondent may be awarded the damages requested since federal jurisdiction has been allegedly shown, even though such damages are not a result of the federal jurisdictional act complained of, ren-

dering the out of pocket rule for defrauded buyers *irrelevant* where there are state fraud damages also claimed (Brief in Opp., p. 13).

To support such assertions, Respondent recites interpretations of the record below that are highly inaccurate and at times scandalous, seeking to confuse the factual foundation of the case, thereby weakening Petitioners' chances of securing review (See Appendix D, p. 1a).

The purpose of this Reply Brief is to respond to Respondent's distortion of the record by a clear showing that there are no operative special facts below that reduce the conflict between the Circuits to merely one in principle.

Respondent has felt free to take liberties with the facts below where no party to this action has heretofore requested that the record be certified to the Court. Accordingly, Petitioners have requested, on September 21, 1973, that the Clerk of the Court of Appeals for the Second Circuit prepare and certify for transmission to the Clerk of the Court a copy of the entire record below.

Petitioners pray that the Court will consider this Reply Brief as well as the record below, and accept their submission as timely under applicable Court Rules. Upon the filing of Respondent's Brief in Opposition, Petitioners have changed legal counsel, causing a slight delay in Petitioners' reply.

The federal question in this case is an unusually important one which will have a significant impact throughout the nation. At least one-third of all federal securities cases are now 10b-5 actions; 1 Bromberg, *Securities Law, Fraud, S.E.C. Rule 10b-5*, §2.5(6). Of these, few are ever

tried, the proportion of settlements being quite high; *Id.*, Volume 2, at §9.1. The Second Circuit's decision below is likely to make such settlements more difficult to achieve in the future, since the parties in 10b-5 actions will have a more difficult time ascertaining the probable worth of future cases under uncertain and expansive damage rules.

In addition to serious issues of federal congressional intent, the decision below raises complex questions concerning the proper allocation of federal judicial resources and the proper relationship between federal and state antifraud provisions of securities laws which only the Court can and should answer. These matters have not been considered by the Court since 1900, and never in connection with contemporary federal securities laws. See *Smith* v. *Bolles*, 132 U.S. 125, 129 (1889); *Sigafus* v. *Porter*, 179 U.S. 116, 123 (1900).

The facts in the instant case warrant and make possible such a review this coming Term, notwithstanding Respondent's misrepresentation of the facts below (which this Reply Brief corrects).

Correction of Record Below

In this action based on allegations of fraud, Counsel for Respondent has—rather paradoxically—sought to gain benefits throughout this litigation by *misrepresenting* the facts of this case. As trial counsel for Petitioners has previously justifiably protested in the District Court, "Plaintiff's papers . . . attempt, by the use of psychologically loaded words and false, slippery reasoning and deliberate distortions and misrepresentations, to demonstrate such

equities in plaintiff's favor and such misconduct on defendants' part as to blind the court to the actual facts" (Stone Reply Affidavit, para. 3, p. 2).

Respondent's Brief in Opposition is no exception. It is a jumble of misstatements, often incorrect, occasionally scandalous, and even seeks to have the Court believe that Petitioners have conceded gross fraud (Brief in Opp., p. 4), an assertion totally without one syllable of support in the record below. Since this is not yet a proceeding on the merits, Petitioners wish to demonstrate Respondent's misrepresentations in appendix form (see Appendix D, p. 1a) at least to put them on the record.

However, since Respondent has made an issue out of the facts, as they relate to Petitioners' chances of gaining review by this Court, Petitioners seek to clarify the facts below and therefore summarize the record which has been certified to this Court, as follows:

The relevant facts in this action have occurred in six stages.

Stage I: Belco Created by Bogue and Incorporated

Belco began as a mere division of Bogue's business. It was incorporated as a separate entity in 1968, and wholly controlled by Bogue until late 1968 when through a public offering of Belco stock Bogue's control was reduced to approximately 75%. Bogue controlled the management and growth of Belco and had the most to gain by Belco's success, until May 1972 when Bogue sold its controlling shares in Belco to Foster-Wheeler. Both corporations during that period occupied space at Bogue facilities. Both corporations worked jointly on mutually advantageous business

ventures. Belco, in particular, received numerous benefits from its close association with its parent corporation (Guttenberg Affidavit, paras. 4-8, pp. 2-3).

Stage II: Intercompany Accounts

Beginning as early as 1968, Bogue and Belco established intercompany accounts to record financial transactions between them. These accounts were *not* started to effect intercompany loans. Belco had no manufacturing capability. Bogue was its major supplier and co-contractor on many projects. The intercompany accounts were necessary for intercompany *business* transactions. Credits or debits in such accounts did not represent intercompany borrowings in fact until the second half of 1970. Before then, the intercompany account was mostly in Bogue's favor, Belco owing Bogue often over $100,000 without any interest charges. Belco, on the other hand, was always credited with 8% interest on amounts owed to it by Bogue (Guttenberg Affidavit, paras. 9-16, pp. 3-7).

Stage III: Collateralization and Repayment of Intercompany Loans

During the first half of 1971 amounts owing Belco by Bogue in the intercompany accounts increased significantly, for the first time exceeding $300,000. This amount being unanticipated by Bogue, Bogue management moved responsibly to secure repayment by executing a promissory note in favor of Belco, at the rate of 8% interest, effective July 1, 1971, secured by 150,000 shares of Belco stock owned by Bogue, and proceeded to make repayment of the amounts owing to Belco, with full 8% interest, during the next ten months. When Bogue's Belco stock was sold to Foster-

Wheeler in May 1972, the entire intercompany account was paid off by Bogue (Reiffin Affidavit, paras. 7-10, pp. 2-4).

Stage IV: Zeller Derivative Stockholder Charges

Coincidentally with a management decision by Bogue and Belco to allow an underwriter's right of first refusal (on any future public offering of Belco stock) to expire, a Belco shareholder of .037% of Belco shares brought suit in the Southern District of New York, alleging state and 10b-5 securities fraud. No effort was made by Plaintiff Zeller to take any discovery proceedings to obtain evidence.* Defendants, however, openly volunteered all relevant information and documents. As soon as Plaintiff Zeller learned of the repayment of the loan, Plaintiff moved for summary judgment and an award of attorneys' fees for its "contribution" in securing repayment. Plaintiff's supporting papers adduced no evidence, but voluminous rhetoric in an attempt to fabricate elements of a 10b-5 action. (See Brief for Appellees in the United States Court of Appeals for the Second Circuit, pp. 3-9.)

Stage V: District Court Proceedings

The District Court denied Plaintiff's motion for summary judgment, and instead granted summary judgment on behalf of Defendants (Pet., Appendix B, pp. 17a-22a). Judge Gurfein, having considered all issues in the case and all evidence in the record, handed down a short opinion which fused facts and law pertaining to the issue of damages. First, he concluded that federal law required a

* The Complaint in this action was based mostly on information and belief. Respondent's failure to place evidence in the record is noteworthy.

showing of out of pocket loss. Second, he concluded that Plaintiff had not substantiated the existence of any triable issue concerning out of pocket loss in relation to the underwriting, the use of the money otherwise in Belco's business, or the interest on the promissory note. (The open account was not considered to be the jurisdictional equivalent of a "security"; hence Judge Gurfein looked only to an out of pocket loss in connection with the note; *id.*, p. 18a.)

Stage VI: Court of Appeals Proceedings

The Court of Appeals also experienced Respondent's style of advocacy: "this is an ugly case . . . ; a corporation was robbed and the malefactors put the money back after they were caught" (Reply Brief for Appellant in the Court of Appeals, p. 24). The Court of Appeals ignored Judge Gurfein's implicit findings of fact in support of his granting of summary judgment, appearing to get lost in Respondent's rhetoric, holding that no matter how remote the chances of proving actual damages, "the judge should have allowed him to try" (Pet., p. 15a). In order to reach this result, the Court of Appeals committed reversible error:

1. The Court of Appeals ignored the substantial evidence in the record in support of Judge Gurfein's conclusion that no out of pocket loss was reasonably at issue below. Petitioner had argued for summary judgment *on the facts* as well as the law.* Although Judge Gurfein's opinion is admittedly terse, in the interests of justice, any close reading of the opinion

* Petitioners (Defendants below) had moved for summary judgment *or* an order dismissing the complaint for want of subject matter jurisdiction pursuant to Federal Rule of Civil Procedure 12(h)(3). The District Court granted the motion for summary judgment (Pet., pp. 19a, 22a).

will confirm that Judge Gurfein's references concerning *loan liability at common law* and *only the amount of the loan leaving Belco's "pocket"* at the conclusion of his opinion were directed not to the issue of fair interest (recovery #1 of the Court of Appeals' opinion) but to the issue of investment in Belco's business (recovery #5 of the Court of Appeals' opinion). See Pet., pp. 21a, 22a, 10a, 11a. Judge Gurfein seemed to assume that the fair interest rate for a loan was a part of the loan, in all essential respects, when the issue was repayment. See his statement, Pet., at 20a: "Bogue then repaid the entire amount owing to Belco with interest at 8%, more than the 7¼% claimed in the complaint." This reading of his opinion is consistent with the fact that Respondent below was claiming 40% interest based on Belco's rate of profit, although the record showed Belco's actual rate of profit on its capital was around 7½% (Guttenberg Affidavit, para. 18). Surely, a trial judge can conclude that there is no issue of fact relating to such a claim. For instance, can there be any doubt that, if Bogue had paid ½% interest on the loan (instead of 8%), Judge Gurfein would have ruled that there was a triable nonrecompensed out of pocket loss? Hence, it would be in error to read Judge Gurfein's opinion as purely a determination on the law of out of pocket loss. It must be read as a finding of fact on the claim of interest advanced by Respondent below. With evidence in the record to justify his decision *on the facts*, the Court of Appeals' substitution of its judgment for his in the procedural posture of this case was reversible error.* Moreover, the Court

* Respondent's Complaint was based principally on information and belief; yet, Respondent initiated no discovery below.

of Appeals, in its opinion, justifies an inquiry on the fair rate of interest because of Bogue's alleged precarious financial condition, ignoring the evidence in the record to the contrary upon which the judgment below must necessarily have been based, and ignoring the substantial collateral which accompanied the loan and the sufficiency of which is now moot.

2. The third theory of recovery identified by the Court of Appeals (profit from Bogue's pledged shares of Belco stock later sold to Foster-Wheeler) goes beyond mere out of pocket loss, and was not even argued below in the District Court.

3. The fourth and fifth theories of recovery mentioned by the Court of Appeals were rejected *on the facts* by the District Court as "speculative" and "conjectured" respectively. The record is devoid of any reason to believe otherwise. It is true that the Court of Appeals has announced a very stiff burden of proof for Respondent in the trial of these issues, Pet., at 14a and 15a, and did "not take a very bright view of plaintiff's prospects on his fourth and fifth issues," *Ibid.*, yet is this not what the out-of-pocket defrauded-buyer rule is designed to avoid—a trial on remote facts with the chances of recovery dim and the consumption of court and litigant resources glaring? Especially in situations where there is no out of pocket loss, as Judge Gurfein ruled in this case, must consequential damages be tried anyway?

4. The Court of Appeals reached out to consider general questions of damages it desired to discuss as if writing a law review article hypothesizing with the aid

> of our facts in the instant action *entirely on the basis of Respondent's complaint and moving affidavit.* In doing so, in order to justify its approaches, it ignored the full record before the District Court *on motion for summary judgment.* Surely, a District Court need not give equal weight to rhetoric and fact in passing upon a motion for summary judgment.

Not only, therefore, did the Court of Appeals announce new law. It did so squarely on the actual facts of this case, upsetting the District Court holding, although it contended it was doing otherwise: "Although most of plaintiff's theories do not involve that issue [of expanded buyer's recoveries] and the ones that do may fail on different grounds, we think it desirable to state our views since the question is fairly raised" (Pet., at 11a).

There are serious questions in this litigation concerning the Court of Appeals' scope of review. The undisputed facts in this case, however, whatever scope of review is employed, place the Court of Appeals' holding in clear conflict with that of the Tenth Circuit for the following additional reasons below:

COUNTER-REASONS FOR GRANTING THE WRIT

The following three points are in response to new matter raised in Respondent's Brief in Opposition. They are numbered in sequence with the first three arguments presented in the Petition.

POINT IV

Certiorari should be granted in view of the clear conflict between the Second and Tenth Circuits as to the proper measure of a defrauded buyer's recoverable damages under the federal securities laws *as applied to the facts below, notwithstanding Respondent's mistaken assertion that the alleged out of pocket loss in the instant case has not been fully recompensed.*

Respondent attempts to side-step the clear conflict between the Circuits pointed out in the Petition (p. 5), which is never directly challenged by Respondent, by asserting that the instant case comes *within* the out of pocket damage rule (Brief in Opp., p. 4). In order to argue this position, Respondent is forced to confuse the actual facts of this case and blur significant distinctions manifest throughout the record below.

Respondent lumps together intercompany open account borrowing occurring before July 1, 1971, and the collateralized note, in asserting that the amount of money Belco parted with was of greater value than the 8% paid by Bogue for use of Belco's money *from 1970 through 1972*. Yet, the Court of Appeals held that the threshold federal issue relates, for purposes of review, *only* to the worth of

the collateralized note and not the open account. Hence, Respondent's burden here is to demonstrate that the note issued on July 1, 1971, caused Belco an out of pocket loss "on account of the act complained of" to bring these facts under the out of pocket loss rule.

However, since all moneys owed to Belco by Bogue had by July 1, 1971, been paid to Bogue on open account, consideration for the note was actually cancellation of the open account which was then bearing 8% interest (the interest also supplied in the note). Any wrongdoing in connection with the loans previously made, which would have required an interest rate in excess of 8%, is not attributable to the making of the note, for which no actual money was paid. Indeed, Respondent incessantly contends throughout this litigation that at the time of the making of the note the open account loans were worthless, suggesting that, if anything, Belco got a greater rate of interest (8%) for the open account loans than the marketplace would have justified (Complaint, para. 10, p. 6).

The flaw in Respondent's reasoning is that, rather than a part of any *plan to defraud* Belco, no other interpretation of the record is justified than that the July 1, 1971, note was a part of a *plan to repay* the open account loans. It would be ironic, indeed, to punish Petitioners for attempting to secure the loans to Belco, when such acts surely should be encouraged by the federal securities laws.

The Court of Appeals thought that Respondent should be allowed to try this issue for the only expressed reason that it was alleged that Bogue had a precarious financial condition during a tight money period (Pet., p. 10a). Yet, the note in issue was supported by *substantial* collateral which

as a matter of law refutes assertions of insecurity. (There is some dispute in the record over the exact worth of the collateral, but agreement on its substantiality.) Since the full amount of the note was repaid with full interest and the value of the collateral actually exceeded the loan, any dispute over sufficiency of collateral is clearly moot.

Since Section 28(a) of the Securities Exchange Act of 1934 mandates a showing of "actual damages on account of the act complained of" (Pet., p. 24a), Respondent's clear inability to show damage to Belco by the making of the collateralized note in the circumstances of this case, such note actually conferring a benefit upon Belco for securing existing indebtedness, requires as a matter of law the dismissal of this action for the reasons and authorities given by the District Court (Pet., pp. 20a-21a). The Court of Appeals' decision to remand this case for trial on this issue is erroneous and clearly in opposition to the result Petitioners would have obtained in the Tenth Circuit. See *Estate Counseling Service, Inc.* v. *Merrill Lynch, Pierce, Fenner & Smith*, 303 F.2d 527 (10th Cir. 1962).

POINT V

Certiorari should be granted in view of the clear conflict between the Second and Tenth Circuits as to the proper measure of a defrauded buyer's recoverable damages under the federal securities laws *as applied to the facts below, notwithstanding Respondent's mistaken assertion that the alleged buyer for jurisdictional purposes in the instant case is really a seller of money for damage purposes.*

Respondent again attempts to escape the argument that there is a clear conflict between the Circuits, advanced by Petitioner (Pet., p. 5), by asserting that the facts in the instant case are "special" and show Respondent to actually be a seller of money, the "practical business substance of its claim" (Brief in Opp., p. 11).

This view, of course, is what *Petitioners* have tried unsuccessfully to argue in the Court of Appeals *as it relates to the issue of there being no security in the case for federal jurisdictional purposes.* If Respondent were a mere lender under a promissory note, a seller of money, it would seem that no security in any meaningful sense would in fact exist, unless perhaps until the note were transferred to a third party, who would then be buying a "security" with a fluctuating value in the commonly understood use of the term.

The Court of Appeals, however, held that Respondent was an "investor" and not a "lender" under federal law, for reasons that were not expressed: "It does not follow, however, that every transaction within the introductory clause of §10, which involves promissory notes, whether of

less or more than nine months maturity, is within Rule 10b-5. The Act is for the protection of investors, and its provisions must be read accordingly. . . . But we see no reason to doubt that Belco stood in the position of an investor, although perhaps an involuntary one, with respect to Bogue" (See Pet., p. 9a).

Respondent cannot have it both ways. The determination of Respondent as an "investor" for jurisdictional purposes carries substantive and not mere semantic weight. For that distinction runs consistently throughout the relevant statutes and the case law in reflecting differing damage postures and private recovery policies. True, a defrauded buyer of a security is in a sense a defrauded seller of what he gave in exchange—usually money, but this claim would be self-defeating as far as the federal securities laws are concerned. The 1933 Act affords remedies to buyers only. The 1934 Act benefits both buyers and sellers, but §3(a)(10) in defining a security, specifically excludes "currency" (15 U.S.C. §78(c)(a)(10)). The distinction has also been treated as one of substance by every court which has considered it, except in the decision of the Court of Appeals below. See *Janigan* v. *Taylor*, 344 F.2d 781 (1st Cir. 1965), *cert. denied*, 382 U.S. 879 (1965); *Levine* v. *Seilon*, 439 F.2d 328 (2d Cir. 1971); *Myzel* v. *Fields*, 386 F.2d 718 (8th Cir. 1967), *cert. denied*, 390 U.S. 951 (1968); compare with *Smith* v. *Bolles*, 132 U.S. 125 (1889).

Respondent's argument also falls because the consideration for the promissory note at issue was not money but cancellation of the open account, which was the result of loans previously made, and according to Respondent, the open account was worthless at the time of the note (July 1,

1971) due to Bogue's alleged insolvency: "During the six months ended June 30, 1971, the individual defendants caused Belco to make additional loans to Bogue aggregating to the sum of $315,310 as of June 30, 1971 . . . Plaintiff is informed and believes that the loans . . . are in jeopardy and probably uncollectible" (Complaint, para. 10, p. 6).

POINT VI

Certiorari should be granted in view of the clear conflict between the Second and Tenth Circuits as to the proper measure of a defrauded buyer's recoverable damages under the federal securities laws *as applied to the facts below, notwithstanding Respondent's mistaken assertion that alleged damages may be awarded in the instant case even though they are not a part of his actual damages on account of the federal jurisdictional act complained of.*

Respondent complains that Petitioners would permit a federal court to "consider a Rule 10b-5 case for securities fraud on a corporation only up until the point where damages in the securities transaction are shown, then close its ears to any further elements of damages recoverable because the securities transaction also involved overreaching by the directors" (Brief in Opp., p. 13). This, like so many other charges by Respondent, is not true.

Actually, Petitioners challenge the Court of Appeals ruling concerning damages for lost profits, gains prevented, and consequential damages (to be awarded in an appropriate case *in addition to* out of pocket damages) because in this case the evidence is and always has been conclusive

that no actual damages in the securities transaction occurred—that is, no out of pocket loss attributable to the making of the promissory note for 8% in exchange for the open account loans.

What Respondent is actually arguing is the position unsuccessfully advanced in the Court of Appeals in Respondent's Brief for Appellant (p. 43) that the federal courts may go on to award state law damages even if federal securities claims are dismissed on jurisdictional grounds—which the District Court, denying federal jurisdiction in the case, refused to do. This accounts for Respondent's repeatedly asserting that the special facts of this case will permit expanded damages without reference to the applicability of the out of pocket damage rule (thus avoiding a conflict between the Circuits). For example:

1. "The fiduciary obligation of the defendants under common law . . . were fused with the normally recoverable damages for violation of the federal securities laws" [referring to the Court of Appeals' decision] (Brief in Opp., p. 4).

2. "Abuse of corporate trust relationships is well within Rule 10b-5 [concerning recoverable damages]" (Brief in Opp., p. 9).

3. "a plaintiff . . . [may] recover under Rule 10b-5 . . . customary damages for an intentional tort, i.e., damages which are naturally caused by the fraud" (Brief in Opp., p. 12).

4. "the traditional duty of a court of equity, in a Rule 10b-5 case or any other action, to fashion a remedy appropriate to the wrong committed" (Brief in Opp., p. 18).

The above expansive damage theories, while appropriate to state law claims (Pet., p. 10), have never been permitted in the federal courts to be applied to alleged defrauding sellers as federal damage measures or for the enforcement of state law claims where no federal fraud jurisdiction was found to exist. For the limits of pendent jurisdiction, see *United Mine Workers of America* v. *Gibbs*, 383 U.S. 715, 726, 727 (1966). The reason is statutory: Failure to show "actual damages on account of the act complained of" in 10b-5 actions is a fatal jurisdictional defect which state law claims cannot cure. See *Estate Counseling Service, Inc.* v. *Merrill Lynch, supra*, 303 F.2d 527, 533; *Smith* v. *Murchison*, 310 F. Supp. 1079, 1084 (S.D.N.Y. 1970); *Commerce Reptg. Co.* v. *Puretec, Inc.*, 290 F. Supp. 715, 719 (S.D.N.Y. 1968); *Cohen* v. *Colvin*, 266 F. Supp. 677, 683 (S.D.N.Y. 1967); and cases cited in Petition, at 6.

Respondent, in calling attention to "special facts" showing alleged mismanagement, fiduciary abuse, and trustee wrongdoing, unintentionally is calling the Court's attention to the central thread of this case: that the essential acts of which Respondent complains concern the open account intercompany borrowings entirely which have been held by the Court of Appeals as not involving a security within the meaning of the 1934 Act (Pet., p. 9a). Respondent's remedy is to bring his action in an appropriate state court, rather than seek a wrenching of federal damage rules. This argument has already been made in the Petition, pp. 10-12.

For Respondent to secure federal relief *on the facts of this case*, the Court of Appeals below had to change 10b-5 damage rules, placing its decision in conflict with those of other Circuits.

CONCLUSION

For the reasons given in the Petition, and in this reply to Respondent's Brief in Opposition, Petitioners pray that the Writ be granted and that the erroneous decision of the Court of Appeals below be summarily reversed *or* that Petitioners be heard on the merits of the case.

Respectfully submitted,

GARY V. DUBIN
Attorney for Petitioners

September 25, 1973

APPENDIX

APPENDIX D

Respondent's Factual Assertions in Its Opposing Brief Compared With Actual Factual Contents of the Record Below

RESPONDENT'S FACTUAL MISREPRESENTATIONS	Nature of Assertion	ACTUAL FACTS FOUND IN RECORD BELOW
1. "the single issue in this case is the measure of recoverable damages" (Brief in Opp., p. 1)	misleading and incorrect	1. Petitioners deny fraud or wrongdoing of any kind; and assertion referring to "this case" suggests that only issue of extent of damages remains. (See Guttenberg Affidavit in Opposition to Motion for Summary Judgment for Resp.)
2. "forced loans . . . at unreasonably low interest rates, at a time when the parent was virtually insolvent and unable to borrow elsewhere, . . . for inadequate compensation, unconscionable profits" (Brief in Opp., p. 1)	misleading and incorrect	2. Respondent's rhetoric was completely refuted in pretrial affidavits, which were never answered by Respondent, although Respondent's rhetoric seeks immortality. (Compare Guttenberg Affidavit with Reply Affidavit of Lawrence Powers, regarding Motion for Summary Judgment)
3. "the parent borrower was virtually insolvent at the time [1970 through 1972]" (Brief in Opp., p. 2)	misleading and incorrect	3. Bogue financial statements refuted this charge. (Para. 3, Reply Affidavit of Guttenberg, never refuted by Respondent)

RESPONDENT'S FACTUAL MISREPRESENTATIONS	Nature of Assertion	ACTUAL FACTS FOUND IN RECORD BELOW
4. "there was no corporate purpose of Belco to be served by the loans" (Brief in Opp., p. 2)	misleading and incorrect	4. Numerous financial advantages to Belco were noted by Petitioners (below); the now-famous reference to the "corporate purposes of Bogue" recital in Belco's loan resolutions was merely inadvertent. (Reiffin Affidavit, paras. 17, 18, 19)
5. "Belco was earning some 40% per annum return on capital" (Brief in Opp., p. 2)	misleading and incorrect	5. Actually under 7½%. (See para. 18, Guttenberg Affidavit)
6. "Belco . . . had better use for the $315,000 in cash working capital in its own business" (Brief in Opp., pp. 2-3)	misleading and incorrect	6. Management of Belco thought otherwise, for good business reasons, while Respondent offers opinion without single fact. (See Guttenberg Affidavit, referenced by Court of Appeals, Pet. 15a, footnote 12)
7. "parent was using the forced financing . . . [for] the speculative carrying of the parent's 75% stock interest in Belco" (Brief in Opp., p. 3)	misleading and incorrect	7. Not one fact in the record to support this assertion; the contrary is proven by Bogue's other assets. (See Reply Affidavit of Guttenberg, para. 4)

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RESPONDENT'S FACTUAL MISREPRESENTATIONS	Nature of Assertion	ACTUAL FACTS FOUND IN RECORD BELOW
8. "virtually a weekly 'dipping into the till' of Belco by its parent whenever cash was needed in 1970 and 1971" (Brief in Opp., p. 3)	misleading and incorrect and scandalous	8. Intercompany transactions between co-contractors and manufacturer and supplier conducted in businesslike manner; went both ways, with Bogue making frequent payments to Belco (and at times Belco, to Bogue); Respondent's reading of ledger sheets supplied by Petitioners (below) shown to be erroneous. (Guttenberg Affidavit, paras. 6-16)
9. "fraudulent corporate 'window dressing' to conceal the abuse of control and misleading filings with . . . [S.E.C.]" (Brief in Opp., p. 3)	misleading and incorrect	9. Common accounting practices followed; effort to involve accountant in alleged fraud shown to be baseless. (Compare Powers and Small Affidavits Re Small's Cross-Motion for Summary Judgment)
10. "When sources of public financing discovered the . . . loans in 1971, a $1,500,000 equity financing . . . was cancelled" (Brief in Opp., p. 3)	misleading and incorrect	10. There was no such financing capable of being cancelled. (Reiffin Affidavit, paras. 23-25; Guttenberg Affidavit, para. 27)
11. "When the plaintiff's stockholder derivative action was brought . . . , Bogue was forced to seek methods for immediate repayment of the loan" (Brief in Opp., p. 3)	misleading and incorrect	11. There is no evidence of any sort to support this conclusion in the record, vital to Respondent's theory of a windfall recovery in attorney fees. This assertion was accordingly rejected by the Court of Appeals. (Pet. 16a)

RESPONDENT'S FACTUAL MISREPRESENTATIONS	Nature of Assertion	ACTUAL FACTS FOUND IN RECORD BELOW
12. "Bogue was required to pay back the forced loan at the closing of the proceeds of sale [to Foster Wheeler]" (Brief in Opp., p. 3)	misleading and incorrect	12. The repayment was only a result of the common practice of paying obligations out of the proceeds; it was not a requirement. (Guttenberg Reply Affidavit, para. 5)
13. "Bogue, on the verge of insolvency, with all credit lines exhausted and several items of corporate debt in default, had no other means of repaying the loans except from the proceeds of sale" (Brief in Opp., p. 3)	misleading and incorrect	13. The contrary is proven in the record. The issue is raised by Respondent (below), answered by affidavit, and never resubstantiated. (See Zeller Affidavit, p. 12; Guttenberg Affidavit, para. 17; Powers Reply Affidavit (no reply))
14. "gross fraud upon Belco, virtually conceded in the relevant documents" (Brief in Opp., p. 4)	misleading and incorrect	14. No gross fraud or any degree of fraud is conceded, "virtually" or otherwise, anywhere in the record below. (See, e.g. Reiffin Affidavit, paras. 7, 27)
15. "a note and . . . collateral to secure the note . . . was an integral part of a plan of fraud and deceit" (Brief in Opp., p. 4)	misleading and incorrect	15. The loans complained of were all made to Bogue before the making of the collateralized note, which was given for securing the repayment in aid of the creditor Belco. The record discloses no evidence of a plan of fraud and deceit.

RESPONDENT'S FACTUAL MISREPRESENTATIONS	Nature of Assertion	ACTUAL FACTS FOUND IN RECORD BELOW
16. "Bogue had exhausted its borrowing powers by 1971, measured by any businesslike standard" (Brief in Opp., p. 5)	misleading and incorrect	16. Bogue actually had an excess of current assets over current liabilities of nearly one and one-half million dollars, New Jersey and Canada real estate with more than eight million dollars of equity value, and over one million dollars in stock holdings; nearly eleven million dollars total assets (unencumbered equity balances) to support new borrowing. (Guttenberg Affidavit, para. 17; Guttenberg Reply Affidavit, paras. 3, 4)
17. "The facts presented to the Court below included the high cost of borrowing in 1970, with corporations paying effective interest rates of 15% to 20% per annum" (Brief in Opp., p. 5)	misleading and incorrect	17. Actually, no reliable evidence of this nature was presented. All that the record discloses is Respondent stating that "on personal experience" (without qualification as an expert) interest rates were 10% to 12% and effectively as much as 15% (considering equity sweeteners)—not 20%. (Zeller Affidavit, p. 11)

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18. "there was . . . theft by a fiduciary" (Brief in Opp., p. 8)	incorrect and scandalous	18. Such statements would be actionable but for their privileged status in a legal proceeding. There is no evidence in the record that justifies such abusive statements. Such statements should be stricken from the record and discouraged.
19. "Bogue admitted in its papers that it had prior offers for Belco's shares from 1971 onward and rejected them to pursue further speculative gain as Belco's profits increased—all at Belco's risk" (Brief in Opp., p. 9)	misleading and incorrect	19. It is admitted only that Bogue had prior offers; the reason for not selling prior to 1972 is not stated in the record, and no admission concerning speculative gain relating to Belco profits was ever made by Bogue, notwithstanding the phraseology carefully employed by Respondent. (See Guttenberg Reply Affidavit, para. 4)
20. "even literal application of the phrase 'out of pocket' meant some $400,000 to Belco because that was the net cost (after commissions and expenses) for $315,000 in cash through a public offering the year before" (Brief in Opp., p. 11)	misleading and incorrect	20. The underwriting costs by express terms were paid by the public and not Belco. (Brief for Appellees Before the Court of Appeals, p. 16)

RESPONDENT'S FACTUAL MISREPRESENTATIONS	Nature of Assertion	ACTUAL FACTS FOUND IN RECORD BELOW
1. "[Bogue] subsequently volunteering of 8% per annum after a suit was prosecuted, is reason enough to see if the facts required a more substantial payment" (Brief in Opp., p. 19)	misleading and incorrect	21. Bogue did not volunteer 8% after suit was brought. 8% interest was paid by Bogue to Belco on the open account more than one year before suit was brought, and six months before suit was filed 8% was listed in July 1, 1971 promissory note. It is very difficult, indeed, to understand the charge that 8% was volunteered after suit when the factual record is consulted. (See Guttenberg Affidavit, para. 15; Levy Affidavit, Note Exhibit)
2. "the motion papers showed that such claim [the aborted underwriting assertion] has substance" (Brief in Opp., p. 19)	misleading and incorrect	22. Actually, the record shows that Bogue rejected the underwriter and not vice versa. (Guttenberg Affidavit, para. 21). The motion papers reveal anything but "substance" for this assertion of a lost underwriting in connection with the loans. The motion papers are based on the hearsay of one not a party to the underwriting negotiations nor an expert in underwriting. (See Zeller Affidavit, paras. 21-23; compare with Reiffin Affidavit, paras. 23-25)